

Internal Revenue Service
memorandum

date: NOV 19 1991

to: District Counsel
Newark, New Jersey

from: Assistant Chief Counsel (Corporate), Branch 4

subject: , ,

[REDACTED]

This memorandum and the attachment have been prepared in response to your request for technical guidance in auditing the [REDACTED] Bankruptcy reorganization. Certain aspects of our analysis remain under consideration in other divisions of the Office of Chief Counsel but will be issued shortly. In particular, the question of which entity should be treated as issuing the replacement bonds (the nominee issue) is under study by attorneys with the Assistant Chief Counsel (Passthroughs and Special Industries) and the Assistant Chief Counsel (Income Tax and Accounting).

Should you have any questions regarding the nominee issue in the meantime, please contact Dan McCabe with CC:P&SI at FTS 343-8558 or Leo Nolan with CC:IT&A at FTS 535-9363. Should you have any questions regarding the corporate issues, please contact Grid Glycer at FTS 566-2457.

By 
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08824

[REDACTED] BANKRUPTCY
RECAST ALTERNATIVES

This summary memorandum is provided as a means for structuring your analysis of tax issues (principally corporate tax issues) arising in the [REDACTED] bankruptcy reorganization. The memorandum discusses in outline form four possible treatments of the overall transaction for federal income tax purposes. The first two should be considered if [REDACTED] is viewed as issuer of the replacement bonds, the second two if [REDACTED] is viewed as issuer. Which entity should be treated as issuer is now being determined by two other offices, the Assistant Chief Counsel (Passthroughs and Special Industries) and the Assistant Chief Counsel (Income Tax and Accounting). Their conclusions will be issued shortly.

Simplified Facts

Before filing a petition for bankruptcy, [REDACTED] owned all the stock of [REDACTED], and [REDACTED] and [REDACTED] were general partners of [REDACTED] ("Partnership"), owning [REDACTED]% and [REDACTED]%, respectively. Partnership in turn owned all the stock of [REDACTED] ("Company"). Company had issued bonds ("Old Bonds") to the public as "nominee" of Partnership; the Old Bonds were secured by the assets of, and guaranteed by, Partnership. Company's business was limited to issuing the Old Bonds.

Pursuant to a plan of reorganization confirmed by the bankruptcy court, the parties undertook the following transaction:

- 1) Holders of Old Bonds ("Holders") surrendered the Old Bonds for stock of [REDACTED] (Class A and Class B), replacement bonds ("New Bonds"), cash in lieu of fractional New Bonds, and interest payments on the New Bonds.
- 2) [REDACTED] contributed [REDACTED] percent of [REDACTED]'s stock to [REDACTED] in exchange for the Class C stock of [REDACTED].
- 3) [REDACTED] formed a new corporation [REDACTED], which received a [REDACTED]% equity interest in Partnership ("Equity Interest"). [REDACTED]'s interest in Partnership was reduced to [REDACTED]% and [REDACTED]'s to [REDACTED]%.

The bankruptcy plan prospectus views Company as agent of Partnership for federal income tax purposes and, consistent with this view, treats the overall transaction as having comprised the following steps:

- P1) Holders contributed part of their Old Bonds to

Partnership in exchange for New Bonds, cash, and interest.

P2) Holders contributed the balance of their Old Bonds to Partnership in exchange for the Equity Interest.

P3) Holders contributed the Equity Interest to [REDACTED] in exchange for the Class A and Class B stock of [REDACTED].

P4) [REDACTED] contributed [REDACTED] percent of [REDACTED]'s stock to [REDACTED] in exchange for the Class C stock of [REDACTED].

P5) [REDACTED] contributed the Equity Interest to [REDACTED] in exchange for the stock of [REDACTED]. [REDACTED] became the managing partner of Partnership.

The prospectus describes the federal income tax consequences of each step as follows:

P1) Holders recognize gain or loss on the exchange under section 1001 and receive interest income under section 61.¹ The cancellation of debt income ("CODI") implications for Partnership are unclear.

P2) The exchange qualifies under section 721.

P3) The exchange qualifies under section 351.

P4) The exchange qualifies under section 351.

P5) The exchange qualifies under section 351.

Issue

How may the transaction described above be recast and what are the resulting tax consequences?

Possible Recasts

I. Treating Partnership as issuer of the New Bonds.

If Partnership is treated as issuer of the New Bonds, as in the prospectus, the transaction may be treated either in the manner described above or as follows.

Recast A.

¹ Since, under any recast, the Holders would have interest income under section 61, this aspect of the transaction will not be discussed further.

A1) Holders contributed their Old Bonds to [REDACTED] in exchange for New Bonds (previously distributed by Partnership to [REDACTED] and then by [REDACTED] to [REDACTED], Class A and Class B stock of [REDACTED], and cash.

A2) [REDACTED] contributed [REDACTED] percent of the stock of [REDACTED] to [REDACTED] in exchange for the Class C stock of [REDACTED].

A3) [REDACTED] contributed the Old Bonds to [REDACTED] in exchange for its stock.

A4) [REDACTED] contributed the Old Bonds to Partnership in exchange for the Equity Interest.

The federal income tax consequences of Recast A would be as follows:

A1) The exchange would be combined with step A2 and qualify under section 351 despite the subsequent transfer of Old Bonds by [REDACTED] to [REDACTED] (Rev. Rul. 77-449, 1977-2 C.B. 110). To the extent gain is realized, Holders would recognize income equal to the cash received and the fair market value of New Bonds. Section 351(b). Since any gain inhering in the New Bonds would have been recognized by [REDACTED] under section 311(b) on the prior distribution of New Bonds to [REDACTED], [REDACTED] would not recognize gain under section 351(f) on its distribution of New Bonds to the Holders.

A2) The exchange would be combined with step A1 and qualify under section 351.

A3) The exchange would qualify under section 351 despite the subsequent transfer of Old Bonds by [REDACTED] to Partnership (Rev. Rul. 77-449).

A4) The exchange would qualify under section 721.

II. Treating Company as issuer of the New Bonds.

If Company is treated as issuer of the New Bonds, the transaction may be viewed in either of two ways.

Recast B

B1) Holders contributed a part of the Old Bonds to Company in exchange for New Bonds and cash.

B2) The Holders contributed the balance of the Old Bonds to [REDACTED] in exchange for Class A and Class B stock of [REDACTED].

The remaining steps are identical to those in A2, A3, and A4 above.

The federal income tax consequences of Recast B would be as follows:

B1) Because the Bonds are securities, the exchange would qualify as a recapitalization under section 368(a)(1)(E). Subject to the principal amount limitation of 354(a)(2), Holders would not recognize any gain or loss on the exchange. Section 354. To the extent gain is realized, however, they would have income equal to the cash received. Section 356(a). Company would recognize CODI under section 108(e)(11).

B2) The exchange would be combined with step A2 and qualify under section 351 despite subsequent transfer of the Old Bonds by [REDACTED] to [REDACTED] (Rev. Rul. 77-449).

The tax consequences for the remaining steps would be identical to those in A2, A3, and A4.

Recast C

C1) [REDACTED] contributed [REDACTED] percent of his [REDACTED] stock to [REDACTED] in exchange for the Class C stock of [REDACTED].

C2) [REDACTED] contributed its Class A and Class B stock to [REDACTED] in exchange for the [REDACTED] stock.

C3) [REDACTED] contributed its [REDACTED] stock to Partnership in exchange for the Equity Interest.

C4) Partnership contributed its [REDACTED] stock to Company in constructive exchange for additional Company stock.

C5) Holders contributed their Old Bonds to Company in exchange for New Bonds, [REDACTED] stock, and cash.

The federal income tax consequences of Recast C would be as follows:

C1) This exchange would be taxable under section 1001.

C2) The exchange would qualify under section 351 despite subsequent transfer of the [REDACTED] stock (Rev. Rul. 77-449).

C3) The exchange would qualify under section 721.

C4) The exchange would qualify under section 351 despite

subsequent transfer of the [REDACTED] stock (Rev. Rul. 77-449).

C5) This exchange would be bifurcated. One exchange would be part of the Old Bonds for New Bonds and cash. As in step B1, the exchange would qualify as a recapitalization under section 368(a)(1)(E). Subject to the limitation of section 354(a)(2), Holders would not recognize gain or loss on the exchange under section 354. To the extent gain is realized, however, they would recognize income equal to the cash received. Section 356(a). Company would recognize CODI under section 108(e)(11). The second exchange would be the balance of the Old Bonds for [REDACTED] stock and would be taxable under section 1001. Possible zero basis problem for Company regarding [REDACTED] Stock.